

# ANALYSIS OF AMENDED BILL

## Franchise Tax Board

Author: Assm. Budget Comm. Analyst: LuAnna Hass Bill Number: AB 1756  
Related Bills: See Legislative History Telephone: 845-7478 Amended Date: June 26, 2003  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Mandatory e-file for tax practitioners

### SUMMARY

This bill would require tax practitioners that prepare more than 100 individual income tax returns in a calendar year to electronically file (e-file) all individual returns with the Franchise Tax Board (FTB) beginning with the following calendar year.

### SUMMARY OF AMENDMENTS

The June 26, 2003, amendments removed the bill's general provision regarding the budget, and replaced it with various provisions relating to state government and the budget, including the provisions discussed in this analysis.

This is the department's first analysis of this bill.

### PURPOSE OF THE BILL

The purpose of this bill is to reduce FTB's cost of processing personal income tax returns.

### EFFECTIVE/OPERATIVE DATE

As a budget trailer provision, this requirement would be effective and operative upon enactment and apply to individual income tax returns that are required to be filed for taxable years beginning on or after January 1, 2004.

### POSITION

Pending.

### ANALYSIS

#### FEDERAL/STATE LAW

Under federal law, income tax returns are in a form prescribed by the Secretary of the Treasury. In addition, federal income tax law has several provisions relating to returns e-filed with the Internal Revenue Service (IRS).

Under current state income tax law relating to e-filing:

- income tax returns must be in a form prescribed by FTB;
- taxpayers must sign written declarations under penalty of perjury; and
- FTB may not require returns of individuals to be on other than paper forms.

Board Position:

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Department Director

Date

Gerald H. Goldberg

7/29/03

## THIS BILL

This bill would:

- remove individuals from the current law prohibiting FTB from requiring tax returns to be filed on anything other than a paper form supplied by FTB;
- require all returns prepared by an income tax preparer that prepared more than 100 timely original individual income tax returns during any calendar year, beginning with the 2003 calendar year, to be e-filed in subsequent years if one or more of those tax returns was prepared using tax preparation software;
- define “income tax return preparer” as:
  - any person that prepares for compensation or employs one or more persons to prepare for compensation any tax return under the Personal Income Tax Laws (PITL);
  - any person that is required to include a tax preparer identification number on a tax return;
- define “original individual income tax return” as a tax return filed by an individual;
- provide that “timely” original individual income tax returns are those returns that are required to be filed during a calendar year, regardless of extensions, which would generally exclude amended returns and prior year returns;
- define “acceptable individual income tax return” as a tax return filed by an individual that FTB determines may be filed using electronic technology;
- provide that the laws regarding administrative regulations and rulemaking are not applicable for purposes of determining which tax returns shall be treated as acceptable individual income tax returns for purposes of this bill;
- define “tax preparation software” as any computer software program intended for accounting, tax return preparation, or tax compliance;
- provide that the requirement to e-file under this bill would not apply during a calendar year if the income tax preparer prepared 25 or fewer returns during the previous calendar year;
- provide that this bill applies to acceptable individual income tax returns required to be filed for taxable years beginning on or after January 1, 2004; and
- provide that the requirement to e-file under this bill would not apply prior to January 1, 2004.

In addition, this bill would provide that an income tax preparer that is subject to the requirements in this bill would be subject to a \$50 penalty for each acceptable individual income tax return that is prepared and then not e-filed, unless the failure to e-file is due to reasonable cause and not due to willful neglect. For purposes of this bill, reasonable cause would include, but not be limited to, a taxpayer’s election not to e-file the return.

## IMPLEMENTATION CONSIDERATIONS

As written, this bill would give FTB the authority to assess a \$50 penalty for each tax return that is prepared by a tax preparer but is not e-filed as required by this bill. However, the bill provides that the tax preparer would not be subject to the penalty if the taxpayer elects not to e-file the tax return. As a result, FTB would have no basis to impose the penalty provided in this bill since the basis of the penalty is the receipt of a tax return that is filed using any method other than electronic filing. The receipt of a tax return filed using a method other than e-file would almost certainly be considered evidence of the taxpayer’s election not to e-file their tax return. Hence, FTB could be unable to assess a penalty. As a result, the penalty in this bill would have no effect, and this would create an opt-out provision that changes the intent of this bill from a mandated program to a voluntary program.

The definition of "tax preparation software" includes software programs intended for tax preparation, accounting, and tax compliance. Generally, tax returns are completed using specific tax preparation software. Although accounting or tax compliance software may provide information helpful in completing a tax return, these software programs generally do not include processes that complete a tax return. A definition this broad could create implementation issues for the department when trying to determine which tax preparers would be subject to the e-file requirement in this bill. Department staff recommends either 1) removing the terms accounting and tax compliance from the definition of tax preparation software, or 2) removing the definition of tax preparation software from the bill.

## LEGISLATIVE HISTORY

A proposal similar to this bill was included in the Governor's Budget Proposal for the 2002/2003 fiscal year that was submitted to the Legislature in January 2002. The proposal failed during department budget negotiations with the Senate Budget Committee prior to the proposal being introduced in a bill.

AB 1748 (Assembly Budget Committee, 2003/2004) and SBX 7 (Senate Committee on Budget and Fiscal Review, 2003/2004) contained a provision similar to the provision discussed in this analysis. However, that provision would have required tax practitioners to file all individual returns with FTB in subsequent years using magnetic media or other machine-readable form. AB 1748 was amended to remove the provision and SBX 7 is with the Assembly Budget Committee.

## PROGRAM BACKGROUND

FTB receives approximately five to seven million tax returns annually that are prepared by tax professionals using a computer and tax preparation software. Although these tax returns are prepared electronically, they are submitted to FTB on paper through the mail. Typically, department operational costs to process paper returns are higher than those costs to process returns received electronically. Once the return is received via mail, the information on the return must be either scanned or manually keyed to transfer the data on the return to department systems.

FTB receives approximately three million e-filed tax returns annually that are prepared by tax professionals. A return that is received electronically is less expensive to process because the information is already in electronic format. In addition, because much of the electronic information can be validated before a return is accepted as filed, the return is less likely to contain errors that result in notices to taxpayers, which further reduces department costs.

## OTHER STATES' INFORMATION

The following states have a requirement similar to the requirement proposed in this bill that would require tax practitioners to e-file tax returns once a specific threshold is attained.

- *Michigan* will require tax preparers that prepare more than 200 returns in 2003 to e-file all subsequent returns beginning in 2004.
- *Minnesota* instituted a similar program with a phase-in approach for those tax preparers that prepared more than 250 tax returns in 2000. The program currently has a 100 tax return threshold.
- *Wisconsin* is similar to *Minnesota* with a phase-in approach of 200 tax returns filed in 2001. The threshold will be reduced to 100 tax returns next year.
- *Ohio* is considering legislation similar to the laws enacted by these states.

## **FISCAL IMPACT**

The proposed Budget Act includes a net reduction in FTB's budget of \$1.23 million and 45.5 PYs in fiscal year 2003/04 for the proposal to mandate e-file for tax practitioners that prepare more than 100 individual income tax returns.

The department may not realize the savings included in the Budget Act due to this bill's penalty provision specifying that the taxpayer may "*elect* not to e-file." The savings above is based on a volume of 2,925,000 returns converting from paper to electronic filing. The conversion of the full volume of returns may not occur with the election. Upon approval of the Budget Act, the department's budget will be reduced to reflect the 45.5 PYs of savings. Due to the election in this bill, these PY's may be needed to maintain the current level of processing and avoid delays in refunds if the volumes of returns above are received via paper instead of electronically.

If the department does not receive the anticipated volume conversion from paper to e-file, a deficiency request and a budget change proposal may be necessary for the permanent restoration of the funds and PYs previously identified as savings.

## **ECONOMIC IMPACT**

This bill would not impact state income tax revenue.

## **ARGUMENTS/POLICY CONCERNS**

Based on the number of tax professionals that have been identified as currently preparing more than 100 tax returns using tax preparation software, the department anticipates that this bill would impact approximately 10,000 tax professionals that do not currently e-file tax returns out of the estimated 40,000 tax professionals that do business in California.

## **LEGISLATIVE STAFF CONTACT**

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